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In The
Supreme Court of the United States

JOHN J. MOORES, et al.,

Petitioners,

v.

ROBERT C. FRIESE,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of California

BRIEF OF AMICI CURIAE TECHNOLOGY NETWORK, CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, CALIFORNIA CHAMBER OF COMMERCE, NATIONAL ASSOCIATION OF MANUFACTURERS, CALIFORNIA MANUFACTURERS AND TECHNOLOGY ASSOCIATION, AND CALIFORNIA BUSINESS ROUNDTABLE IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

Whether, with respect to a claim of breach of official duty to a corporation, the Commerce Clause permits a State to substitute its own substantive law for that of the State of incorporation.

Whether the Due Process Clause permits the directors and officers of a corporation incorporated in one State to be sued under the substantive law of another State for alleged breach of official duty to the corporation.

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INTEREST OF *AMICI CURIAE*[1]

Technology Network ("TechNet") is a network of Chief Executive Officers and senior partners of more than 150 companies in the information technology, biotechnology, venture capital, investment banking and legal industries. The association is organized to promote the growth of the technology industry and the economy by building long-term relationships among technology leaders. As members and investors in the technology and biotechnology industries, TechNet's members represent the leading edge of developing, manufacturing, and marketing emerging technologies.

The question presented by this case – whether the federal Constitution permits California to regulate the relationship between a Delaware corporation and its own directors and officers – is an issue of recurring importance for members and investors in the emerging technology industries. The majority of TechNet's members lead companies capitalized through publicly traded shares. Many – including California icons like eBay, Genentech, Google, Intel, Oracle, and Yahoo! – are incorporated in Delaware. Companies choose to incorporate Delaware in part because of its well-developed, predictable corporate law. Companies and their officers, directors, shareholders and investors rely on knowledge that Delaware law will apply to their corporate affairs.

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[1] Counsel of record for all parties have consented to the filing of this brief and the consents are being filed with the Clerk of the Court simultaneously with this brief. Pursuant to this Court's Rule 37.6, *amici* state that no counsel for any party authored this brief in whole or in part, and no person or entity other than *amici*, their counsel and their members made a monetary contribution to the preparation or submission of the brief.

High-tech companies' stock prices are often volatile, as the market potential of their emerging technologies waxes and wanes. Due to this volatility, technology companies and their officers and directors are frequent targets of private securities litigation. Insider-trading claims, such as this suit, are especially common in the wake of a change in stock price. TechNet's members are affected directly by the decision of the court below to allow California law to create treble damage liability in favor of a Delaware corporation against its board members.

The Chamber of Commerce of the United States of America is the world's largest business federation, representing an underlying membership of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in the courts on issues of vital concern to the nation's business community. Many Chamber members are incorporated in Delaware, but have their principal places of business in California (or elsewhere) and so are vitally affected by the decision below which undermines the internal affairs doctrine.

The California Chamber of Commerce is the largest voluntary business association within the State of California, with more than 15,000 members, both individual and corporate, representing virtually every economic interest in the state. The California Chamber acts on behalf of the business community to improve the state's economic and jobs climate by representing business on a broad range of legislative, regulatory and legal issues. The California Chamber participates as *amicus curiae* only on matters that have a significant impact on California businesses, such as this case.

The National Association of Manufacturers is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media and the general public about the vital role of manufacturing to America's economic future and living standards. Many of the NAM's members are incorporated in Delaware but have their principal places of business in California (or elsewhere), and so are vitally affected by the decision below.

The California Manufacturers & Technology Association is a non-profit corporation established to advocate for state laws and regulations that will enhance the business climate for California's 30,000 manufacturing, processing and technology-based companies. As part of its efforts, the CMTA seeks to develop and sustain consistent and predictable laws applicable to manufacturers and the broader business community. Many CMTA members are incorporated in other states but do significant business in California. For this reason, they are vitally concerned about the outcome of this case.

The California Business Roundtable is a nonpartisan organization composed of chief executives and senior officers of companies doing business in California. It represents virtually every major industry segment in the state. The Roundtable was created to permit senior business leaders to play an active role in the formulation and evaluation of public policy, and advocate for a strong economy and a healthy business climate in California. Many of its members are incorporated in other states,

often Delaware, but are headquartered or do significant business in California. They are vitally concerned about California's attempts to apply California law to internal affairs of Delaware corporations.

SUMMARY OF ARGUMENT

The Petition for a Writ of Certiorari presents a recurrent, important conflict concerning the federal constitutional limits on one State's power to regulate internal affairs of corporations incorporated in another State.

Following this Court's lead, Delaware courts have repeatedly held as a matter of federal constitutional law that a corporation's internal affairs must, except in rare cases, be governed exclusively by the law of the state of incorporation. *McDermott Inc. v. Lewis*, 531 A.2d 206 (Del. 1987); *Draper v. Gardner Defined Plan Trust*, 625 A.2d 859 (Del. 1993); *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005). In contrast, California has repeatedly tried to regulate internal affairs of corporations incorporated elsewhere (often Delaware), and California courts have repeatedly upheld such laws against constitutional challenge. *Western Air Lines, Inc. v. Sobieski*, 12 Cal. Rptr. 719 (Cal. Dist. Ct. App. 1961); *Wilson v. Louisiana-Pacific Resources, Inc.*, 187 Cal. Rptr. 852 (Cal. Ct. App. 1982); *Havlicek v. Coast-to-Coast Analytic Services, Inc.*, 46 Cal. Rptr. 2d 696 (Cal. Ct. App. 1995); Petition for Writ of Certiorari ("Pet.") App. A-E.

This conflict has deepened to the remarkable point of requiring the Delaware Supreme Court to hold a California statute unconstitutional. *See VantagePoint*, 871 A.2d 1108.

The conflict is exacerbated by the decision below. A Delaware corporation (Peregrine Systems, Inc., through its

litigation trustee, respondent Friese) seeks to hold its former directors (petitioners) liable for alleged misuse of corporate information for personal benefit. A director's or officer's liability to the corporation is generally an internal matter governed solely by the law of the state of incorporation – here Delaware. *See Shaffer v. Heitner*, 433 U.S. 186, 215 n.44 (1977); *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982) ("matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders" should be governed by law of state of incorporation); Restatement (Second) Conflict of Laws § 309 & cmt. a. Indeed, a director's or officer's relationship to the corporation cuts to the core of a corporation's internal affairs. The California court here nevertheless holds that California law applies to that relationship, and moreover subjects the directors to massive treble-damages liability that Delaware does not impose. As a result, directors and their corporations cannot predict which state's law will govern their responsibilities to each other or the consequences should they be deemed in breach.

Delaware's and California's conflicting views on the scope of the Commerce and Due Process Clauses are both entrenched, and only this Court can resolve the dispute. The Court should do so now. Healthy interstate commerce depends on predictable and stable legal rules. The particular issue here – California's attempt to intrude its law into the relationship between a Delaware corporation and its directors – is important in its own right given Delaware's prominence as the state of incorporation of half the nation's publicly traded businesses, and California's prominence as a center of business activity. Further, the dispute is not limited to the West Coast. New York, another critically important state, also purports to intrude its law into the relationship between directors and any foreign

corporation doing business in the state. *See* N.Y. Bus. Corp. Law §§ 1317(a), 719, 720.

Uncertainty over which state's law applies undermines the very interests that the Commerce Clause and Due Process Clause were meant to protect. It also takes away the very stability and predictability that corporations seek by incorporating in Delaware in the first place.

The Court should grant certiorari to resolve the conflict.

ARGUMENT

This Court has long recognized that "only one State should have the authority to regulate a corporation's internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders – because otherwise a corporation could be faced with conflicting demands." *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982). Of particular import here – where respondent seeks to hold a Delaware corporation's directors liable to the corporation under California law – "the law of the State of incorporation is held to govern the liabilities of officers or directors to the corporation." *Shaffer v. Heitner*, 433 U.S. 186, 215 n.44 (1977).

This rule is firmly grounded in practical reality. Directors' duties to their corporations need to be uniform. They also should not vary with the directors' respective residences or travels. Nor should directors be left to guess which states might assert authority. Our economy thrives when people can understand the rules applicable to their conduct, reliably foresee the consequences of their actions and promptly resolve any disputes related to their actions. The directors' duties to their corporation should therefore be resolved by the laws of a single state.

The decision below, however, disregards this principle, and exacerbates a continuing conflict between Delaware and California courts over the scope of two federal constitutional provisions.

First, the United States Constitution delegates to Congress the "Power . . . [t]o regulate Commerce . . . among the several States." U.S. Const. art. I, § 8, cl. 3. Under the dormant Commerce Clause, a state "has no interest in regulating the internal affairs of foreign corporations." *MITE*, 457 U.S. at 645-46. Application of "the law of the state of incorporation" alone to a corporation's internal affairs achieves "the need for certainty and predictability of result while generally protecting the justified expectations of parties with interests in the corporation." *First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611, 621 (1983); *see also Shaffer*, 433 U.S. at 215 n.44 (internal affairs doctrine is based on "the need for a uniform and certain standard to govern the internal affairs of a corporation"). Our free market system "depends at its core upon the fact that a corporation – except in the rarest situations – is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation." *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 90 (1987).

In addition, the Fourteenth Amendment's Due Process Clause protects the right of every person to "fair notice" of both "the conduct that will subject [them] to punishment" and "also of the severity of the penalty." *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 574 (1996). No less than others, a corporation's directors – and its officers, its stockholders and the corporation itself – are entitled to fair notice of

what law will govern their relationships and of the liabilities and the penalties that will attach to a violation.

Petitioners in substance ask the Court to take this case to decide whether the Commerce Clause and Due Process Clause allow a state to substitute its own substantive law, concerning a corporation's internal affairs, for that of the state of incorporation. As detailed below, the conflict between Delaware and California cases on this issue is real, and prompt resolution is important.

I. THE CONFLICT IS REAL AND PERSISTENT.

A. Delaware Cases Hold That a State Cannot Constitutionally Regulate Foreign Corporations' Internal Affairs.

The Delaware Supreme Court has laid down a clear, predictable rule. As a matter of federal constitutional law, and with only rare exceptions, the law of the place of incorporation exclusively governs a corporation's internal affairs.

In *McDermott Incorporated v. Lewis*, 531 A.2d 206 (Del. 1987), the Delaware Supreme Court held that a corporation's internal affairs must be governed by the law of its place of incorporation as a matter of federal constitutional law. At issue was whether a Delaware subsidiary, which owned shares in its Panamanian parent corporation, could take part in a vote of the parent's shareholders. The law of the place of incorporation, Panama, permitted subsidiaries to vote. *Id.* at 209-14. Delaware law prohibited subsidiaries from voting. *Id.* at 212. The Delaware Supreme Court held that Panamanian law must control under both the Fourteenth Amendment's Due Process Clause and the Commerce Clause.

As to Due Process, "directors and officers have a significant right, under the fourteenth amendment's due process clause, to know what law will be applied to their actions. Stockholders also have a right to know by what standards of accountability they may hold those managing the corporation's business and affairs." *Id.* at 216-17. Application of Delaware law "would unfairly and, in our opinion, unconstitutionally, subject those intimately involved with the management of the corporation to the laws of Delaware." *Id.* at 218.

As to the Commerce Clause, *McDermott* continued, this Court's decisions in *MITE*, 457 U.S. 624, and *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987), established that a state "has no interest in regulating the internal affairs of foreign corporations" and that a corporation's internal affairs must "except in the rarest situations" be governed by "the corporate law of the state of its incorporation." *McDermott*, 531 A.2d at 217 (quoting *MITE* and *CTS*). "Since a state has no interest in regulating the internal affairs of a foreign corporation under *MITE*, Delaware has nothing left" to justify the burden on commerce from regulating a foreign corporation's internal affairs. *Id.* at 219. Application of Delaware law to a corporation incorporated in Panama would therefore violate the Commerce Clause. *Id.* at 218-19.

The Delaware Supreme Court reaffirmed this constitutional rule in *Draper v. Gardner Defined Plan Trust*, 625 A.2d 859 (Del. 1993). In a derivative action concerning a Delaware corporation, parallel litigation was pending in Delaware and California state courts. The Delaware trial court granted plaintiffs' voluntary motion to dismiss the Delaware suit in favor of the California suits. The Delaware Supreme Court affirmed, on the ground that

California would be constitutionally required to apply Delaware law. *Id.* at 864-65. Specifically, the court rejected defendants' prediction that if the Delaware suit were dismissed, the California courts would resolve the dispute under California rather than Delaware law governing a pre-suit demand on the board of directors. *Id.* at 864-69. Repeating that "application of the internal affairs doctrine is mandated by constitutional principles" under Due Process and the Commerce Clause "except in 'the rarest situations,'" the court could see "no reason" that California courts would refuse to apply Delaware law given "the vitality and constitutional underpinnings of the internal affairs doctrine." *Id.* at 866-68.

These holdings were further cemented in *Vantage-Point Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005). The Delaware Supreme Court there held a California statute unconstitutional because it purported to regulate a Delaware corporation's internal affairs. Delaware law, together with the corporation's certificate of incorporation, mandated that a merger be authorized by all stockholders voting as a single class. *Id.* at 1111. California law, however, required that each class of shareholders vote separately. *Id.* at 1109-10 n.1. California Corporations Code section 2115 purported to impose this California requirement even on foreign corporations that had specified California contacts. *Id.*

The Delaware Supreme Court reaffirmed its established law that federal Due Process protected corporate actors' rights to know what standards would govern, and that the Commerce Clause negated any interest of one state in "regulating the internal affairs of foreign corporations." *Id.* at 1113 (citing *McDermott, MITE* and *CTS*). Among other things, uncertain application of another

state's law would "completely contravene[] the importance of stability within inter-corporate relationships that the United States Supreme Court recognized in *CTS*." *Id.* at 1115. It would also be "disruptive" for "different internal affairs rules to operate intermittently within corporation relationships under either the law of California or the law of the state of incorporation," depending on "the vi[ci]ssitudes of the ever-changing facts." *Id.* Therefore, the Court held, "the federal constitution mandated that Examen's internal affairs . . . be adjudicated exclusively in accordance with the law of its state of incorporation. . . . " *Id.* at 1116.

McDermott, Draper and *VantagePoint* represent entrenched, bright-line Delaware Supreme Court holdings that the Commerce and Due Process Clauses mandate that a corporation's internal affairs be governed only by the law of the state of incorporation. Applied to this case, the liability of petitioners to their Delaware corporation must be governed exclusively by Delaware law.

B. California Cases Hold That California May and Does Regulate Foreign Corporations' Internal Affairs.

In contrast, California courts have repeatedly upheld intrusion of California law into internal affairs of corporations incorporated in Delaware and elsewhere.

In *Western Air Lines, Inc. v. Sobieski*, 12 Cal. Rptr. 719 (Cal. Dist. Ct. App. 1961), the state of incorporation, Delaware, permitted a corporation to eliminate cumulative shareholder voting for its board of directors. Shareholder voting is a matter "peculiar to the relationships among or between the corporation and its . . . directors[] and shareholders," *MITE*, 457 U.S. at 645, and so within the

internal affairs doctrine. The California courts nevertheless held that the California Commissioner of Corporations may constitutionally bar a Delaware corporation from eliminating cumulative voting. Over the corporation's objection that the method of shareholder votes for the board of directors was an "internal affair" subject only to Delaware law, the California court held that California law properly applied to "corporate dealings with residents of this State." *W. Air Lines*, 12 Cal. Rptr. at 725, 727. It concluded that application of California law did not violate the federal Due Process, Full Faith and Credit, Equal Protection or Contract Clauses. *Id.* at 727.

Similarly, *Wilson v. Louisiana-Pacific Resources, Inc.*, 187 Cal. Rptr. 852 (Cal. Ct. App. 1982), upheld California's authority to regulate internal affairs of a foreign corporation. The corporate law of the state of incorporation, Utah, allowed the corporation to provide that shareholders' votes for the board of directors would be non-cumulative. *Id.* at 856. A California statute nevertheless provided that California corporate law applied because the corporation had specified California contacts. *Id.* at 854-55. California law required cumulative voting. *Id.* at 855. The California court, citing *Western Air Lines*, rejected all federal constitutional challenges to application of California's cumulative-voting requirement. It held that the "internal affairs doctrine" "has never been followed blindly in California" and is "not determinative of the constitutional issue." *Id.* at 858 (discussing full faith and credit). It rejected Commerce Clause and Due Process challenges to application of California law, holding that the burden on commerce was "incidental," application of California law was not "irrational," and the corporation had sufficient "contacts with California" to warrant application of California law. *Id.* at 858-62.

The California courts again upheld application of California law to an out-of-state corporation's internal affairs in *Havlicek v. Coast-to-Coast Analytic Services, Inc.*, 46 Cal. Rptr. 2d 696 (Cal. Ct. App. 1995). There the state of incorporation, Delaware, allowed directors to inspect corporate documents, but only for purposes reasonably related to the director's position as director. *Id.* at 699. California law authorized a director to inspect for any purpose. *Id.* The California court held that application of California's law did not violate the Commerce Clause. *Id.* at 701.

The decision below expands California's attempt to intrude its law into the internal affairs of foreign corporations. Peregrine Systems was incorporated in Delaware. Its articles of incorporation specified that Delaware law governed the scope of directors' liability to the corporation, and the articles eliminated directors' liability for monetary damages "to the fullest extent permissible under Delaware law." Pet. 6 n.2. The court below nevertheless ruled that the directors were subject to liability for treble damages under California Corporations Code section 25502.5. It did so despite clear arguments that such liability would, as the Delaware Supreme Court holds, violate the Commerce and Due Process Clauses. Pet. App. I 36a-44a.

So interpreted, Section 25502.5 unquestionably regulates foreign corporations' internal affairs. A director's or officer's liability to the corporation is a "matter peculiar to the relationship[] . . . between the corporation and its current . . . directors," *MITE*, 457 U.S. at 645, and so is normally an internal affair governed by the law of the state of incorporation. *See Shaffer*, 433 U.S. at 215 n.44; Restatement (Second) Conflict of Laws § 309 & cmt. a. Otherwise different directors would owe the corporation

different, possibly conflicting, duties, and directors' duties would change as they traveled from state to state. Section 25502.5 holds officers and directors liable to their corporations, and does so based on their positions *as officers and directors*. *See* Cal. Corp. Code § 25402 (barring, *inter alia*, "an officer, director or controlling person of an issuer" from buying or selling issuer's securities in California while in possession of material nonpublic information); § 25502.5(a) (issuing corporation may recover treble damages for violation of § 25402).[2] Application of section 25502.5 to hold respondent directors liable to their Delaware corporation is unconstitutional under the Delaware Supreme Court's construction of the Commerce and Due Process Clauses in *McDermott, Draper* and *VantagePoint*.

Nothing in the opinion below dispels this conflict. The court held that section 25502.5 fell outside the internal-affairs doctrine on the ground that it was enacted to deter insider trading, as part of California's corporate securities law. *See* Pet. App. E 12a-26a. But a constitutional *purpose* is not enough. California must use constitutional *means*.

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[2] In addition, section 25502.5 explicitly regulates the board of directors' quorum, voting and other requirements. If a shareholder demands that the corporation sue its directors, "the board [of directors] shall be required to consider the allegation in good faith," and a director accused of misconduct "may be counted in determining the presence of a quorum at a meeting of the board or a committee of the board" but, on matters related to the accusation, "shall not be entitled to vote." *Id.* § 25502.5(c). Standards and procedures for board of directors votes are normally internal affairs governed only by the law of the state of incorporation. *See MITE*, 457 U.S. at 645 ("matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders" are subject to internal-affairs doctrine); *McDermott Inc. v. Lewis*, 531 A.2d 206, 218-19 (Del. 1987) (shareholder voting rights are internal affairs governed only by law of place of incorporation).

See, e.g., Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959) (despite constitutionally permissible safety purpose, state law requiring mudguards on trucks impermissibly burdened interstate commerce and violated Commerce Clause). Under the Delaware Supreme Court's interpretation of the federal Constitution in *McDermott* and progeny, the means employed by California here are unconstitutional. Directors' liability to the corporation, as an internal affair, must be regulated solely by Delaware law.

In sum, whereas Delaware holds as a matter of federal constitutional law that a corporation's internal affairs are governed "exclusively in accordance with the law of its state of incorporation," *VantagePoint*, 871 A.2d at 1116, California holds that it may regulate internal affairs of Delaware corporations. The conflict is real, pervasive and entrenched. Only this Court can resolve it.

II. THE CONFLICT IS IMPORTANT AND SHOULD BE RESOLVED NOW.

Resolution of this conflict is important to businesses such as *amici's* members, which depend on predictability to manage their affairs. The holding below, giving a Delaware corporation a treble-damages claim against its own directors under California law, is particularly likely to inflict lasting damage if not promptly corrected.

To begin with, application of out-of-state law to a Delaware corporation's internal affairs affects an enormous number of corporations and a large sector of the nation's economy. Half of all U.S. publicly traded companies and 60% of Fortune 500 businesses are incorporated in Delaware. *See* State of Delaware, Division of Corporations, http://www.state.de.us/corp (visited August 9, 2006). Delaware is the state of incorporation of many businesses

whose principal places of business lie in other states, including many of *amici's* members. Pp. 1-4 above. Any of these corporations may have directors or officers who visit or live in California and buy or sell stock while in the state, subjecting them to a treble-damages cause of action by their corporation or those purporting to act for it.[3]

In addition, states other than California seek to impose their laws into the relationship between Delaware corporations and their directors. New York, for example, purports to regulate liability of directors of any out-of-state corporation doing business in New York. *See* N.Y. Bus. Corp. Law § 1317(a) (with specified exceptions, "the directors and officers of a foreign corporation doing business in this state are subject, to the same extent as directors and officers of a domestic corporation, to the provisions of" sections 719 and 720); § 719 (holding "directors . . . jointly and severally liable to the corporation" for specified acts as director); § 720 (authorizing causes of action against director and providing that action under sections 719 and 720 may be brought, *inter alia*, by the "corporation" or in shareholder derivative suit).

Thus two of the nation's most important economic powerhouses – New York and California – seek to impose their law on corporations incorporated in Delaware, the state of incorporation of half of the nation's large corporations. Delaware rejects their attempts. Directors and corporations are caught in the middle. They cannot predict whether Delaware's or some other state's law will govern.

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[3] Any insider who buys or sells a security "in this state," *i.e.* California, is subject to the insider-trading law, and so to section 25502.5. *See* Cal. Corp. Code § 25402 (barring insider trading "in this state"); § 25502.5 (treble-damages remedy for violation of § 25402).

Delaware, or California, or New York, or some other law may define each director's duties to the corporation, depending on where the director is and which state's court is interpreting the federal Constitution.

That uncertainty is intolerable. It strikes at the heart of the efficiency and predictability protected by the Commerce Clause and Due Process Clause in the first place, and indeed at the reason businesses incorporate in Delaware in the first place. "In corporation law, uncertainty about what the law is or what law is applicable to a given transaction constitutes a far more serious problem than in areas of the law which do not require comprehensive and continuous planning." Michael J. Halloran & Douglas L. Hammer, *Section 2115 of the New California General Corporation Law – The Application of California Corporation Law to Foreign Corporations*, 23 UCLA L. Rev. 1282, 1283 (1976).

Businesses *choose* to incorporate in Delaware largely to avoid such uncertainty. *See* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 Tex. L. Rev. 469, 484 (1987) (businesses choose Delaware in part because of "greater predictability with respect to corporate legal affairs"); Rodman Ward Jr. & Erin Kelly, *Why Delaware Leads in the United States as a Corporate Domicile*, Del. Law., Fall 1991, at 15, 16 ("[O]ther states have a paucity of court opinions interpreting their corporate statutes, and, often, the judicial interpretations that do exist do not afford the same level of certainty and predictability to practitioners using their corporate codes."); William Jarblum & Bernard D. Bollinger, Jr., *Incorporation Issues: Why Delaware?*, Am. Bankr. Inst. J., Oct. 1999, at 6, 6 ("The corporation law of Delaware is widely regarded as the most extensive and well-defined body of corporate law in the United

States. . . . There is an anticipation that the Delaware General Corporation Law will continue to be interpreted and construed in significant court decisions, lending predictability to the corporate legal affairs of all corporations that are domiciled in Delaware."). The predictability that corporations seek, and promise to their directors, is eviscerated if other states can intrude their laws after the fact.

Nor should this Court wait to review the issue. The decision below, if not corrected, will have an immediate impact on the directors and officers whom it exposes to California law and on the out-of-state corporations whose internal affairs California attempts to regulate. Under California law, "Decisions of every division of the District Courts of Appeal are binding . . . upon all the superior courts of this state. . . ." *Auto Equity Sales, Inc. v. Superior Court*, 369 P.2d 937, 940 (Cal. 1962). California trial courts are thus required to follow an intermediate court of appeal decision such as the decision below. *Id.* Absent review by this Court, trial courts in California will be obliged by the decision below, when on point, to permit treble-damages claims by non-California corporations under section 25502.5 to proceed against their directors and officers.

Moreover, such claims in practice will be brought not at the corporation's election, but in derivative suits controlled by class-action lawyers. A § 25502.5 claim belongs to the corporation, but can be brought by a shareholder via a shareholder derivative suit. The 1995 Private Securities Litigation Reform Act imposed stricter pleading standards for private securities-fraud actions. *See* 15 U.S.C. § 78u-4. The Securities Litigation Uniform Standards Act of 1998 preempted many state securities-fraud suits – but exempted derivative claims. *See* 15 U.S.C. § 78bb(f)(5)(C). As

a result, shareholders bring investor fraud claims as derivative actions. The upshot is that the treble-damages liability to which California exposes foreign corporations' directors is not only potentially massive but unpredictable. It will impair many non-California corporations' ability to recruit and retain qualified directors.[4]

In short, the conflict between Delaware and California courts undermines the important federal interests in "certainty and predictability of result" and "protecting the justified expectations of parties" at the heart of the internal affairs doctrine. *First Nat'l City Bank*, 462 U.S. at 621; *see also Shaffer*, 433 U.S. at 215 n.44; p. 7 above; *Nagy v. Riblet Prods. Corp.*, 79 F.3d 572, 576 (7th Cir. 1996) ("A single rule for each corporation's internal affairs reduces uncertainty" and enables corporate actors to make choices, "confident that they can predict the legal effect.").

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[4] Experience teaches that the threat of massive damages will deter qualified directors from serving:

> In 1985, after the Delaware Supreme Court found the directors personally liable for deciding to accept a buyout offer in *Smith v. Van Gorkom*[, 488 A.2d 858 (Del. 1985)], the number of shareholder derivative suits brought for a breach of the duty of care dramatically increased. This, in turn, caused insurance rates for director and officer liability coverage to increase and, in some cases, corporations were unable to obtain insurance. Many directors, concerned about the prospect of being found personally liable for astronomical amounts, resigned their positions. Predictably, this has had an effect on corporations' ability to recruit qualified directors and officers.

Demetrios G. Kaouris, *Is Delaware Still a Haven for Incorporation?*, 20 Del. J. Corp. L. 965, 987 (1995) (citing Lynne A. Whited, Note, *Corporate Directors – An Endangered Species? A More Reasonable Standard for Director and Officer Liability in Illinois*, 1987 U. Ill. L. Rev. 495, 495-96, 504-05 (1987)).

CONCLUSION

For these reasons, *amici* respectfully urge the Court to grant certiorari.

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